IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 72 of 1988

For Approval and Signature:

Hon'ble MR.JUSTICE M.S.SHAH
and
Hon'ble MR.JUSTICE D.A.MEHTA

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

AMRISH & CO.

Versus

COMMISSIONER OF INCOME TAX

Appearance:
1. INCOME TAX REFERENCE No. 72 of 1988
MR JP SHAH for Petitioner
MR AKIL KURESHI with MR MANISH R BHATT for Respondent

CORAM : MR.JUSTICE M.S.SHAH
and
MR.JUSTICE D.A.MEHTA

Date of decision: 30/10/2001

ORAL JUDGEMENT

(Per : MR.JUSTICE D.A.MEHTA)

The Income-tax Appellate Tribunal, Ahmedabad

Bench "C" has referred the following question under Section 256(1) of the Income-tax Act, 1961 (hereinafter referred to as "the Act') for the opinion of this Court:-

"Whether on the facts and in the circumstances of the case, the sum of Rs. 1 lakh debited in the accounts as payable to M/s Chunilal Pranjivandas & Co. for the use of their office, telephone, staff and other facilities was a deductible item of expenditure ?"

2. The assessment year is 1981-82 and the relevant accounting period is calendar year 1980. The assessee, which is a registered firm, occupied office premises situated at Manekchowk, Ahmedabad of one M/s Chunilal Pranjivandas & Co. of Bombay and also utilized telephone and staff of the said firm. The assessee had similarly occupied these premises and utilized the facilities since calendar year 1977. It appears that there is no written agreement between the parties. However, the assessee debited in its books a sum of Rs.1,00,000/- towards user of the premises, telephone and staff for the year under consideration on the basis of mercantile system of accounting, which the assessee is following, and claimed the same as a deductible item of expenditure against its taxable income.

3. The Assessing Officer after going through the entry made in the books of accounts made inquiries with M/s Chunilal Pranjivandas & Co. at Bombay vide letter dated 28.2.1984. M/s Chunilal Pranjivandas & Co., Bombay replied vide letter dated 10.3.1984 and the Assessing Officer has extracted the following portion from the said letter -

"HOWEVER COMPENSATION FROM JANUARY 1980 TO OCT 80 IS YET TO BE AGREED AND TO BE RECEIVED",

and relying upon the same, concluded that the claim of the assessee was not in relation to a accrued liability, but it was only a contingent liability.

4. The Commissioner Income-tax (Appeals) upheld the action of the Income-tax Officer stating that it was an unascertained liability which had not been quantified and hence, as no demand was made by the Bombay firm, it cannot be said that any liability to make payment had arisen.

5. The Tribunal confirmed the decision of the lower

authorities on the footing that in the year under appeal there was no evidence of any oral or documentary claim and that there were no facts to show that any known or ascertained liability had come into existence. The Tribunal further observed that at the best it could be considered to be an ad-hoc provision bordering on the definition of a contingent liability and was uncertain of being discharged. The Tribunal also distinguished its own order for the immediately preceding assessment year 1980-81, wherein the Tribunal itself had allowed such liability pertaining to calendar years 1977, 1978 and 1979.

6. We have heard Mr JP Shah, learned counsel appearing on behalf of the applicant-assessee and Mr Akil Kureshi, learned standing counsel appearing on behalf of the respondent-revenue.

7. Mr Shah submitted that the Tribunal and the authorities erred in holding that there was no ascertained liability, because there was no dispute to the fact that the assessee firm had in fact utilized the premises of the Bombay firm as well as the facilities of telephone and the staff. It was submitted that once this was the position, on the basis of system of accounting regularly employed by the assessee firm i.e. mercantile system, as a prudent businessman, the assessee firm was required to debit the cost of user of the premises and facilities and arrive at the actual income liable to be taxed. Our attention was invited to page 65 of the paper book wherein the basis for quantifying the liability of Rs.1,00,000/- has been furnished and it was pointed out that having regard to the details the liability had been satisfactorily estimated. In support of these submissions, reliance was placed on the decisions of the Apex Court in the case of Calcutta Co. Ltd. vs. CIT, 37 ITR 1 and in the case of Bharat Earth Movers vs. CIT, (2000) 245 ITR 428. Mr Shah also submitted that Section 70 of the Contract Act which fell in Chapter V pertaining to `Quasi Contracts' bearing heading `OF CERTAIN RELATIONS RESEMBLING THOSE CREATED BY CONTRACT' made it apparent that once it was established that the Bombay firm had not permitted user of the premises and the facilities gratuitously and that the assessee firm had enjoyed the benefits, the assessee firm was bound to compensate the former in respect of availing of such benefits.

8. In reply, Mr Kureshi, learned counsel emphasized the fact that the assessee had shifted its stand vis-a-vis the one taken up in assessment year 1980-81;

that in the said assessment year liability pertaining to three years, namely calendar years 1977, 1978 and 1979 had been claimed only when the demand had been made by the Bombay firm and the assessee should not now be permitted to conveniently change its stand when undisputedly there was no claim made by the Bombay firm, no debit note had been issued by the Bombay firm nor was any quantification available during the year under consideration. He further submitted that mere user by itself was not sufficient for accrual of the liability and as found by the Tribunal, the letter dated 10.3.1981 did not raise any demand nor did it quantify any liability on the basis of which the Bombay firm would claim the rent for the user of the premises and the facilities. Mr Kureshi extensively read from the Tribunal's order for assessment year 1980-81 to show that for the immediately preceding year the assessee had made a claim only on the basis of a demand made by the Bombay firm and not on the basis of accrual of liability as per the mercantile system of accounting. It was, therefore, submitted that, it was not now open to the assessee to depart from its own version, that of accrual of liability based on the debit note issued in the earlier year i.e. on 31.12.1979.

9. In rejoinder, Mr Shah pointed out that in so far as payments relatable to calendar years 1977 and 1978 were concerned, the assessee had not debited in its books of accounts because the assessee was under an impression that the Bombay firm had possibly permitted the assessee to use the premises and facilities gratuitously, but immediately when the demand was made in 1979 by issuance of debit note, the assessee had debited the entire sum relatable to the three years as on 31.12.1979 and what was more important was that the Tribunal had accepted the explanation tendered by the assessee and that position was no longer in dispute. It was, therefore, submitted that the aforesaid order of the Tribunal pertaining to assessment year 1980-81 instead of assisting the revenue supported the stand of the assessee in as much as the position was that the assessee was bound to make payment for the user of the premises and facilities and based on the system of accounting regularly employed, as per the settled legal position, the assessee had rightly debited the amount in question in its books and claimed the same as a deductible item of expenditure.

10. As to when a business liability arises is an issue which is no longer res integra. The Supreme Court in case of Bharat Earth Movers (supra) has laid down the law in the following terms :-

"The law is settled : if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain."

Thereafter in the same decision, after quoting the facts in earlier decision in case of Metal Box Company of India Ltd. vs. Their Workmen, (1969) 73 ITR 53, the following principles have been culled out :-

"A few principles were laid down by this Court, the relevant of which for our purpose are extracted and reproduced as under :-

(i) For an assessee maintaining his accounts on the mercantile system, a liability already accrued, though to be discharged at a future date, would be a proper deduction while working out the profits and gains of his business, regard being had to be accepted principles of commercial practice and accountancy. It is not as if such deduction is permissible only in the case of amounts actually expended or paid;

(ii) Just as receipts, though not actual receipts but accrued due are brought in for income-tax assessment, so also liabilities accrued due would be taken into account while working out the profits and gains of the business;

(iii) A condition subsequent, the fulfillment of which may result in the reduction or even extinction of the liability, would not have the effect of converting that liability into a contingent liability;

(iv) A trader computing his taxable profits for a particular year may properly deduct not only the payment actually made to his employees but also the present value of any payments in respect of their services in that year to be made in a subsequent year if it can be satisfactorily estimated."

11. Applying the aforesaid test, it is apparent on the facts of the present case that the assessee as a trader while computing its taxable profits for the year under consideration was properly required to deduct not only the payments actually made for use of premises and facilities but also the present value of any payments in respect of such use in that year though payable in a subsequent year in case such liability could be satisfactorily estimated. As already seen, the assessee has given detailed working of the estimated liability for the year under consideration and there is no dispute as regards the same. Furthermore, merely because subsequently there may be a reduction or even extinction of liability, it would not have the effect of converting such accrued liability into a contingent liability.

12. In so far as assessment year 1980-81 is concerned, on which great reliance was placed on behalf of the revenue, the facts as recorded by the Assessing Officer show that the matter was settled on 31.12.1979 and the Bombay firm demanded a sum of Rs.1,22,615/- from the assessee for calendar years 1977, 1978 and 1979; that the assessee had initially provided for Rs.75,000/- on the basis of debit note but subsequently vide letter dated 31.3.1983 made an additional claim of Rs.46,615/over and above the provision made. Thus, the facts available on record go to show that the assessee claimed the liability not only for calendar year 1979 which had already been provided in the books during assessment year 1980-81, but also liability relating to calendar years 1977 and 1978 on the basis of demand made for the first time as it was under a bona fide belief till that point of time that it was permitted user of the premises and the facilities gratuitously. Therefore, there is no inconsistency in the stand adopted by the assessee in the immediately preceding assessment year and the assessment year under consideration and that the Tribunal committed an error when it distinguished its own order for the immediately preceding assessment year.

13. Before parting, we may observe that the provisions of Section 41(1) of the Act provide for a safeguard in an eventuality where the liability is

allowed as a deduction in the particular assessment year and subsequently on remission or cessation thereof, the assessee obtains some benefit as regards the same in a subsequent year.

13. We therefore hold that the assessee was entitled to the deduction of Rs.1,00,000/- debited in the accounts as payable to M/s Chunilal Pranjivandas & Co. for the use of their office, telephone, staff and other facilities and the Tribunal was not justified in denying such claim.

14. The question referred to us is, therefore, answered in the affirmative i.e. in favour of the assessee and against the revenue.

The reference is disposed of accordingly with no order as to costs.

(M.S. Shah, J.)

(D.A. Mehta, J.)

sundar/-